MEMORANDUM

To: Commissioners, Robin, Staff

From: Al

Date: September 16, 2003

Re: General Information on Utility Bankruptcy

INTRODUCTION

Bankruptcy is a process by which debtors are rehabilitated and given a chance for a new financial start. The underlying philosophy behind bankruptcy is that when debtors cannot possibly fulfill their financial obligations they and their creditors should accept the losses and begin anew. Bankruptcy law is the province of the federal government.[1] There are five basic types of bankruptcy, referred to by their chapter number in the Bankruptcy Code[2]: Chapter 7 – Liquidations; Chapter 9 – Municipalities; Chapter 11 – Reorganizations; Chapter 12 – Family Farmers; and Chapter 13 – Wage Earners.

From the end of the depression era until 1988, no major electric or gas utility company filed for bankruptcy protection. Since January 1988, four major utilities have filed for protection under Chapter11: Public Service Company of New Hampshire (PSNH) -- 1988; El Paso Electric Company (EPEC) -- 1992; Cajun Electric Power Cooperative, Inc. (Cajun) -- 1994; Columbia Gas Systems, Inc. (Columbia) -- 1991; and Pacific Gas and Electric (PG&E) -- 2001. Three of four have emerged from bankruptcy. PG&E remains in litigation as to which of the competing plans of reorganization will be

[1] U.S. CONST. art. I, § 8, cl. 4.
[2] Bankruptcy Reform Act of 1978, 11 U.S.C. 101 et seq. (2000).

approved. Additionally there have been several smaller utilities which have filed for reorganization under Chapter 11, including Big Rivers Electric Corporation, Colorado—Ute Electric Association, Inc., Eastern Maine Electric Cooperative, Inc. and Wabash Valley Power Association. It is highly probable that any utility bankruptcy which the Commission might face would be a Chapter 11 case. This memorandum focuses on that Chapter.

EXECUTIVE SUMMARY

If a utility files for bankruptcy protection, the commission, if it chooses, will probably be allowed to participate in the proceeding. If the commission is not a creditor, the most advantageous status would be that of a party-in-interest. In the only reported litigation on this issue, the primary commission was granted party-in-interest status.

Ratemaking is not subject to the automatic stay of action which comes into effect at the moment of filing. Consequently, the commission retains its ratemaking authority. However, the bankruptcy court is given broad authority, and may enjoin the commission from taking some ratemaking actions. Probably a court would interfere with commission authority only if the commission action threatened to prevent all feasible reorganization plans. The courts have split on the question of whether or not a commission can lower rates because of the filing of a bankruptcy. No court has ordered a commission to raise rates during a bankruptcy.

In a Chapter 11 bankruptcy, the utility should continue to operate during the proceeding. Either a trustee or the debtor-in-possession will continue to operate the business. The primary duty of whomever operates the business is to maximize the value of the assets for the benefit of creditors and equity-holders. If, during the bankruptcy, the trustee or debtor-in-possession desires to enter into transactions that are not in the ordinary course of business, those transactions must be approved by the bankruptcy court and should be subject to whatever commission review and approval would be required if a bankruptcy proceeding did not exist.

Bankruptcy law does not require that the commission approve a plan or reorganization. In each case so far, the highest court has decided that bankruptcy law preempts all other law so that neither a statute, nor a commission can prevent any transactions required by an approved plan. If a plan of reorganization anticipates that new rates will be charged, the plan can be confirmed only if the commission authorizes the new rates.

OVERVIEW OF CHAPTER 11 BANKRUPTCY[3]

Chapter 11 provides a process whereby a debtor may attempt to reorganize itself by restructuring debt, assets, and business and liquidating assets in an orderly fashion. Generally creditors look to the future earnings of the debtor rather than the property itself. To understand the process one must first understand a number of key concepts and procedures that are fundamental to any proceeding:

1. Bankruptcy Estate,
2. Automatic Stay,
3. Priority of Claims,
4. Post-Petition Interest,
5. Avoiding Powers, and
6. Plan of Reorganization.

[3] The material in this section is adapted from Ralph R. Mabrey and Patrick S. Malone, *Chapter 11 Reorganization of Utility Companies*, 22 ENERGY L.J. 277, 278-283 (2001).

Each of these concepts is explained below.

The Bankruptcy Estate

When a debtor files a bankruptcy petition, an estate consisting of all of the debtor's property and interests is created as a matter of law. For a corporation, all of the legal and equitable interests in property owned by the debtor at the time of filing are included. The business of the debtor is continued, operated either by the "debtor-in-possession" or by a court-appointed trustee.[4] The debtor-in-possession is usually the same management as operated the company before bankruptcy. However, the obligation of the operator changes with the bankruptcy filing. Prior to filing the company would have been managed to maximize profits for shareholders; after filing the company must be managed to maximize the value of the bankruptcy estate primarily for creditors.

The Automatic Stay

Filing of a bankruptcy petition triggers an automatic stay which prohibits most actions against the debtor by all entities. It is very broad and automatic. Among other things, it bans the commencement or continuation of a judicial, administrative, or other action against the debtor that was or could have been commenced prior to the filing.[5] A creditor may petition the bankruptcy court for relief from the stay only when the property at issue is not necessary for a successful reorganization and the debtor has no equity in the property or when there is other "cause" such as a lack of "adequate protection". This

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[4] A court-appointed trustee is not the same as the U.S. Trustee. The U.S. Trustee is a government official who performs administrative tasks which would otherwise be the responsibility of the Bankruptcy Judge.
[5] 11 U.S.C. § 362(a)(1) (2000).

is the case when a secured creditor's collateral is depreciating at a rate which impairs the creditor's secured position.

An important exception to the automatic stay is the commencement or continuation of an action or proceeding by a governmental unit to enforce the governmental unit's police and regulatory power, including enforcement of a judgment other than a money judgment.[6] The limits of this exception are discussed below.

Priority of Claims Against the Estate

Due to the automatic stay, creditors are prevented from taking any action to recover on the debtor's obligations. Consequently either pre-petition creditors must file a claim with the bankruptcy court or the debtor must have scheduled the creditor's claim as uncontested. If neither of these is done in a timely manner, the creditor is barred from any remedy.

Secured claims are paid first to the extent that they are secured. If the value of collateral is less than the secured creditor's claim, the excess claim is considered an unsecured claim. Administrative expenses, including the expenses necessary to continue the debtor's operation during the pendency of the bankruptcy proceeding, are paid next. Remaining unsecured creditors take according to their priority as established by the Bankruptcy Code.[7]

Post-Petition Interest

[6] 11 U.S.C. § 362(b)(4) (2000 and Supp. 2002).
[7] 11 U.S.C. § 507 (2000). With some limitations and exceptions, for a utility bankruptcy the order is (1) Wages, (2) Employee Benefit Plans, (3) Deposits for services or products not delivered, (4) Obligations to Governmental Units, (5) All Others.

Filing a bankruptcy petition places a moratorium on the payment or accrual of post-petition interest. There are two exceptions to the moratorium. One, if a secured creditor is "over-secured" the creditor is entitled to post-petition interest. A creditor is over-secured if the value of the assets securing the obligation to the creditor is greater than the amount of the secured obligation. Second, if the bankruptcy estate has sufficient assets to pay pre-petition claims in full, creditors are entitled to post-petition interest. In a bankruptcy involving large amounts of unsecured and under-secured debt, this moratorium, along with the debtor's right to suspend principal payments, can free large amounts of cash normally dedicated to debt service.

Avoidance Powers

Avoidance is a bankruptcy term-of-art which should be thought of as recovery of payments of money or transfers of property previously made, or cancellation of contracts not yet fully performed. For example, a trustee may choose to recover any payment made to an unsecured creditor during the applicable period, or the trustee may choose to cancel a QF contract.

The bankruptcy trustee or the debtor-in-possession has the power to avoid certain payments and to reject burdensome executory contracts. The trustee/debtor-in possession may avoid a payment as a "preference" when the debtor transfers property of the debtor to or for the benefit of a creditor on account of pre-petition debt made while the debtor is insolvent within 90 day of filing (1 year if creditor beneficiary is an insider) that enables the creditor to receive more than it would have under a Chapter 7 filing.[8]

Not every payment or transfer can be recovered. A creditor has certain defenses to a preference action which reduce the risk of dealing with a financially distressed

[8] 11 U.S.C. § 547(b) (2000).

company. First, if a transfer was made in the ordinary course of business and in line with terms utilized in the industry the transfer may not be avoided as a preference. Second, if the parties contemplated a contemporaneous exchange, and in fact the transaction involved a substantially contemporaneous exchange, the transfer may not be avoided as a preference. Third, if after receiving the transfer the creditor supplies new value the transfer may not be avoided to the extent of the new value.[9]

A trustee/debtor-in-possession may also recover any property that was "fraudulently transferred". A transfer is fraudulent if (1) the debtor engaged in the transaction with intent to hinder, delay, or defraud a creditor, or (2) the debtor received less than reasonably equivalent value and the debtor was insolvent at the time of transfer, was rendered insolvent as a result of the transfer, or was left with unreasonably small capital after the transfer.[10] A transfer which is fraudulent under state law may also be set aside.[11]

The trustee/debtor-in-possession also has the power to assume and reinstate pre-petition leases and contracts or to reject burdensome pre-petition executory contracts and leases. Any breach of contract damages that result from a rejection is treated as an unsecured debt. Furthermore, damages for rejection of leases and employment contracts are limited.

Plan of Reorganization

The goal of any Chapter 11 bankruptcy is for the court to confirm a plan of reorganization that classifies all creditors' claims and interests and discharges those claims and interests according to its terms. A proposed plan is described in a disclosure

[9] 11 U.S.C. § 547(c) (2000).
[10] 11 U.S.C. § 548(a)(1)(B) (2000).
[11] 11 U.S.C. § 544(b) 2000.

statement. For a period of time only the debtor may propose a plan. After expiration of the exclusive time period, any party in interest may propose a plan. Each class of creditor and shareholder which is impaired votes on the plan. For the court to confirm the plan, the plan must be in the "best interests of the creditors", and if any class voted to reject it but at least one impaired class voted to accept, the plan must not unfairly discriminate and be fair and equitable with respect to each impaired class that rejected. A plan is in the best interests of the creditors if each dissenting creditor receives as much as it would have under Chapter 7. A plan is fair and equitable if it meets the absolute priorities test; no inferior class receives anything until any superior dissenting class is paid in full. Equity is last in line.

Once a plan is confirmed, the debtor's pre-petition obligations are discharged in accordance with the plan and the debtor emerges from bankruptcy after the plan is effective. The confirmed plan is binding on all parties in interest.

PERTINENT HIGHLIGHTS OF RECENT UTILITY BANKRUPTCIES

In re Public Service Company of New Hampshire

This was the first major utility to file for bankruptcy protection since the 1930's. PSNH provided electric service to more than 400,000 homes and businesses. It was an integrated electric utility with generation, transmission, and distribution assets. It had invested approximately $2.9 billion in the Seabrook Station nuclear power generating facility (Seabrook). Under New Hampshire law the construction investment was not included in PSNH's rate base until the plant was actually online. PSNH was not able to service its debt and filed bankruptcy on January 28, 1988.

This complex bankruptcy raised several novel issues of law and involved considerable litigation over many points. One of the factors repeatedly emphasized by the court was that the problem was circular. The value of PSNH depended primarily on the rates that it could charge; the rates it could charge depended on its value. Eventually all parties, including New Hampshire, agreed to a capitalization which quadrupled PSNH's rate base. The Governor and Attorney General of New Hampshire approved a rate agreement which allowed PSNH to raise retail rates by 5.5% each year for seven years. NHPUC approved the new rates.

PSNH emerged from bankruptcy on May 16, 1991; approximately one year later PSNH was acquired by Northeast Utilities.

The court's decisions on several issues provide guidance as to the role and power of regulatory commissions in utility bankruptcy cases.

<u>Intervention</u>

The State of New Hampshire requested that the court find that it was a party in interest or, alternatively, that the court allow it to intervene as an interested entity. The State claimed that it was a creditor, that through its public utility commission (NHPUC) it was the primary regulator of PSNH, that through its Attorney General it was the principal representative of commercial and residential electric consumers, and that it would have a significant role in PSNH's reorganization.[12]

The New Hampshire Office of Consumer Advocate (OCA) requested that the court find that it was a party in interest or, alternatively that it be allowed to intervene

[12] *In re Public Service Company of New Hampshire*, 88 B.R. 546, 548 (Bankr. D.N.H. 1988).

generally.[13] The OCA claimed that it was an independent office created by the legislature to represent the interests of residential utility consumers in any proceeding involving those interests, that the rights and interests of residential utility consumers would not be adequately represented by any other party, and that residential utility consumers would bear a major part of the consequences of the case.[14]

The Connecticut Department of Public Utility Control (DPUC) requested that the court find it to be a party in interest or, alternatively, that the court allow it to intervene generally. The DPUC claimed that it was the Connecticut agency responsible for regulating utility companies operating in Connecticut, that PSNH as owner of the Millstone Unit 3 Nuclear Generating Facility in Waterford, Connecticut, was subject to its regulatory authority, that the joint ownership of Seabrook by PSNH with two Connecticut utility companies gave Connecticut and its ratepayers a substantial interest in the case, and that the future level of rates required to be paid by Connecticut consumers could be affected by the bankruptcy case.[15]

PSNH and the Official Committee of Unsecured Creditors opposed all motions for party in interest status and for general intervention.[16]

The court granted the State of New Hampshire and the NHPUC party in interest status, granted OCA limited intervention rights, and denied DPUC's motion without prejudice so that it could seek to be heard on specific issues affecting it.[17]

<u>Interim Ratemaking</u>

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[13] The Business and Industry Association of New Hampshire (BIA) made a similar request with respect to the interests of business ratepayers. The court treated it the same as the OCA.
[14] 88 B.R. at 549.
[15] *Id*. at 548-49.
[16] 88 B.R. at 549-50.
[17] *Id*. at 556-57.

NHPUC began an involuntary rate case against PSNH in January of 1989 when it appeared that the company was earning in excess of its allowed annual rate of return. From January through December of 1988, the company averaged a return of approximately 17.5%; in January of 1989 a 16.6% annualized return triggered the involuntary rate case.

PSNH sought an injunction to prevent NHPUC from proceeding with the involuntary rate case. The bankruptcy court, using its authority under 11 U.S.C. 105 granted the injunction.[18] NHPUC did not appeal the bankruptcy court's order.

Preemption

PSNH proposed a reorganization plan which called for disaggregating its assets by creating generating and transmitting company and a distribution company which would purchase power from its affiliate. The generating and transmitting company would be subject to regulation by FERC, under whose rules it could included up to 50% of the Seabrook construction costs in its rate base.

New Hampshire law required NHPUC approval for the transfer of assets,[19] the mortgage of property,[20] the issuing of securities,[21] and contracts with affiliates.[22] PSNH initiated a declaratory judgment action against NHPUC in an adversary proceeding and sought an order that federal bankruptcy law preempted state law requirements.[23] Specifically, PSNH claimed that 11 U.S.C 1123(a)(5) preempted any state law and that

[18] *See In re Public Service Co. of New Hampshire*, 98 B.R. 120 (1989)
[19] N.H. Rev. Stat. Ann. §§ 374:30-31.
[20] N.H. Rev. Stat. Ann. § 369:2.
[21] N.H. Rev. Stat. Ann. §§ 369:1, 369:7.
[22] N.H. Rev. Stat. Ann. § 366:5.
[23] *In re Public Service Co. of New Hampshire*, 108 B.R. 854, 857-58 (1989).

the only approval required from NHPUC was the approval of rates as required by 11 U.S.C. 1129(a)(6).[24]

Section 1123(a)(5) of the Bankruptcy Code provides:

§ 1123. Contents of plan.
(a) Notwithstanding any otherwise applicable nonbankruptcy law, a plan shall –
(5) provide adequate means for the plan's implementation such as –
(A) retention by the debtor of all or any part of the property of the estate;
(B) transfer of all or any part of the property of the estate to one or more entities, whether organized before or after the confirmation of such plan;
(C) merger or consolidation of the debtor with one or more persons;
(D) sale of all or any part of the property of the estate, either subject to or free of any lien, or the distribution of all or any part of the property of the estate among those having an interest in such property of the estate;
(E) satisfaction of any lien;
(F) cancellation or modification of any indenture or similar instrument:
(G) curing or waiving of any default;
(H) extension of a maturity date or a change in an interest rate or other terms of outstanding securities;
(I) amendment of the debtor's charter; or
(J) issuance of securities of the debtor, or of any entity referred to in subparagraph (B) or (C) of this paragraph, for cash, for property, for existing securities, or in exchange for claims or interests, or for any other appropriate purpose;

Section 1129(a)(6) of the Bankruptcy Code provides"

§ 1129 Confirmation of Plan.
(a) The court shall confirm a plan on if all of the following requirements are met:
(6) Any governmental regulatory commission with jurisdiction, after confirmation of the plan, over the rates of the debtor has approved any rate change provided for in the plan, or such rate change is expressly conditioned on such approval.

The bankruptcy court, after considering statutory history, the traditional power of the states over utility regulation, the public interest factor, the plain meaning of the statute, and prior cases regarding federal preemption of state law,[25] concluded that §

[24] *Id*. at 858.
[25] *Id*. at 863-887.

1123(a)(5) preempted New Hampshire's laws requiring NHPUC approval of restructuring transactions.[26]

In re El Paso Electric Company

EPEC was an integrated electric utility with generation, transmission, and distribution facilities serving approximately 270,000 customers in West Texas and Southern New Mexico. EPEC had incurred substantial debt related to construction of the Palo Verde Nuclear Generating Facility near Phoenix, Arizona. EPEC negotiated a financial restructuring with its primary lenders and requested a rate increase of $131.3 million. In November 1991, the Public Utility Commission of Texas (PUCT) authorized $47 million of the request. EPEC could not complete the debt restructuring, was unable to meet its obligations as they became due, and filed a Chapter 11 bankruptcy petition on January 8, 1992.

Unlike PSNH and NHPUC, EPEC and PUCT did not engage in extensive litigation; there are no reported bankruptcy court decisions. EPEC negotiated a rate agreement with the City of El Paso which included a $25 million rate base increase and froze rates for ten years. PUCT approved the new rates and EPEC was able to restructure its debt and equity and emerge from bankruptcy.

Secured creditors received 100% of their secured claims; unsecured creditors received up to 85% of their claims in reissued stock. 15% of the new stock was distributed to previous shareholders (12% preferred and 3% common).

News reports indicate that while EPEC is a viable concern today, it imposes some of the highest electric rates in the country.

In re Cajun Electric Power Cooperative, Inc.

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[26] *Id.* at 889.

Cajun was a large generation and transmission electric cooperative serving eleven member cooperatives that provided electricity to more than 1,000,000 Louisiana customers. Cajun owned a 30% interest in River Bend Nuclear Station in addition to coal and natural gas generation plants. Cajun owed $4.2 billion to Rural Utilities Services (RUS), $1.6 billion of which was related to construction of River Bend, and about $7 million to 750 unsecured trade creditors.

In December 1994, the Louisiana Public Service Commission (LPSC) ordered Cajun to reduce its members' rates from 54.5 mills/kWh to 48.8 mills based partially on LPSC's determination that Cajun's investment in River Bend was not used and useful. RUS asserted that it, not LPSC, had authority over Cajun's rates. On December 21, 1994, Cajun complied with the LPSC order and thereby breached its lending agreements. On December 22, 1994, Cajun filed a Chapter 11 petition and requested the bankruptcy court to determine which regulator had authority over its rates.

In 1995 the court appointed a trustee to operate Cajun's business.[27] The court found that Cajun's directors, who were all representatives of Cajun's member customers had conflicts of interest. The court accepted the assertion that the directors main interest was low rates rather than to maximize the value of the bankruptcy estate.

Over the next several years, during the pendency of extensive litigation, Cajun continued to operate. Finally, in 1999 the parties in interest reached a settlement agreement which was approved by the district court. LPSC and FERC both approved the reorganization plan and the rates associated with it.[28] Many of the interim decisions of the courts provide guidance for regulatory commissions facing a utility bankruptcy.

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[27] For conciseness and clarity, actions of the Chapter 11 trustee are referred to as actions of Cajun.
[28] *In re Cajun Elec. Power Co-op., Inc.*, 238 B.R. 319 (Bankr. M.D. La. 1999).

Intervention

Unlike the PSNH case, there is no reported decision granting LPSC a right to intervene. However, LPSC took an active role and was a frequent litigant. Whether or not the bankruptcy court issued an order, LPSC was treated as a party-in-interest.

Interim Rates

The issues regarding interim ratemaking were some of the most litigated and instructive issues with respect to regulatory authority. On January 24, 1996, LPSC re-opened is rate docket (Rate Docket) to consider the rates that Cajun could charge its members, and opened another docket (Contract Docket) to consider the validity of certain contracts between Cajun and its members. Specifically, with regard to rates, the LPSC was concerned that Cajun's rates included a component for interest on pre-petition debt which was neither being paid nor accrued during the bankruptcy. Cajun brought a adversary proceeding against LPSC seeking to enjoin the LPSC from pursuing either docket. LPSC suspended the dockets but expanded the scope of the reopened docket. The bankruptcy court issued an oral order enjoining the LPSC from pursuing the Contract Docket and allowed the Rate Docket to proceed. The bankruptcy court cautioned LPSC that any matters in the Rate Docket beyond traditional ratemaking would be subject to the court's scrutiny.[29]

The LPSC continued hearings under the Rate Docket and eventually issued an order that the amount of Cajun's rates which was attributable to debt service could continue to be collected but must be deposited in an escrow account pending

[29] *In re Cajun Elec. Power Co-op., Inc.*, No. 96-1073, 1998 Bankr. LEXIS 1941, at *9 (Bankr. M.D. La. Apr. 2, 1998).

determination by the bankruptcy court of Cajun's interest expense. Cajun then brought a second adversary action against LPSC to enjoin it from considering arguments that the rates should be lowered.

The bankruptcy court, relying on the PSNH preemption decision, technicalities regarding the dischargeability, and a concern that the cooperative equity owners, who were also the ratepayers were attempting to elevate themselves ahead of creditors, granted Cajun a permanent injunction that LPSC could not lower rates because of the Chapter 11 filing and the suspension of debt service.

LPSC appealed the bankruptcy court's decision to the federal district court which affirmed, and to the Court of Appeals for the Fifth Circuit which reversed. The Appeals Court did not decide the preemption issue, but ruled that issuance of an injunction terminating the escrow account constituted an abuse of discretion.[30] The settlement between LPSC, RUS, and Cajun provided that two-thirds of the escrow fund was to be refunded to the ratepayers and one-third was transferred to RUS. The lower rate imposed by the Rate Docket became the rates which applied after confirmation of the reorganization.

<u>Preemption</u>

As discussed above, the bankruptcy court ruled that federal bankruptcy law preempted Louisiana state law. The Court of Appeals did not decide this issue. After this case, the PSNH decision remained the most persuasive authority on this issue.

In re Columbia Gas Systems, Inc.

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[30] *In re Cajun Elec. Power Co-op., Inc.*, 185 F.3d 446, 452 (5th Cir. 1999).

Columbia, with its affiliates, comprised one of the largest natural gas systems in the United States.[31] The organization was composed on public utility holding company, a service company, and nineteen subsidiaries engaged primarily in exploration, production, storage, transmission, and distribution of natural gas, at both wholesale and retail. In 1991 Columbia negotiated a settlement of a class action suit arising out of Columbia's underpayment on gas contracts. The settlement required Columbia to make an immediate deposit of $15 million into an escrow account and to deposit an additional $15 million in March 1992. The district court approved the settlement and it became final and non-appealable on July 18, 1991. On July 31, 1991, Columbia filed a Chapter 11 bankruptcy petition.

The areas of major litigation during the bankruptcy proceedings concerned whether or not the settlement agreement was an executory contract which Columbia could accept, whether certain funds received by Columbia pursuant to FERC orders were property of the estate, and entitlement to fees. Columbia achieved its major objective in rejecting its remaining long-term take-or-pay contracts which were no longer economical. The damage claims were settled for approximately one tenth of their face amount.[32]

Although there were no formal orders granting various utility commissions party-in-interest status, the agencies were allowed to participate in many of the proceedings.[33]

In re Pacific Gas and Electric

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[31] *In re Columbia Gas System, Inc.*, 146 B.R. 106 (D. Del. 1992).

[32] Ralph R. Mabrey and Patrick S. Malone, *Chapter 11 Reorganization of Utility Companies*, ENERGY L. J. 22:277, 288 (2001).

[33] *See In re Columbia Gas Systems, Inc*, 997 F.2d 1039 (3rd Cir. 1993) (Pennsylvania Public Utility Commission, Maryland Public Service Commission, and Public Utilities Commission of Ohio were parties).

PG&E was caught between regulated, rate-frozen retail distribution and FERC approved market-based wholesale prices during California's energy crisis of 2000 and 2001. Retail rates had been frozen at their June 10, 1996 level as part of California's electric deregulation process. The belief at the outset was that this would allow utilities to recover their stranded costs associated with deregulation. When wholesale prices rose, the retail rates were insufficient to cover the cost of power purchases. On April 6, 2001, PG&E filed a Chapter 11 petition. In its petition, PG&E represented that it had assets of $24.2 billion and debt of $18.4 billion.

This proceeding is ongoing. As of June 16, 2003, the official docket contains 12965 separate filings. There has been extensive litigation in bankruptcy court, district court, and the Court of Appeals. There are competing plans of reorganization, the two main ones having been proposed by PG&E and CPUC. Currently, the parties are subject to an order to engage in settlement discussions. A status conference at which the parties are to present the results of their settlement discussions, originally scheduled for May 12, (60 days after the bankruptcy court stayed all action in the plan confirmation phase) has twice been continued, and is now scheduled for June 20, 2003.

Some of the decisions reached by the various courts are informative as to the role of regulatory commissions in a utility bankruptcy.

Intervention

Intervention by CPUC has not been an issue in this case. CPUC is a creditor of PG&E. Consequently, CPUC did not need to seek designation as a party-in-interest or as a general intervenor.

Interim Rates

Under California law retail electric rates were frozen until the earlier of March 31, 2002, or the date on which the stranded costs associated with the transition to deregulation were fully recovered by the retail utility. CPUC created two accounts, a Transition Revenue Account (TRA) which accounted for monthly revenues, and a Transition Cost Balancing Account (TCBA) which accounted for the utility's transition costs. The TRA balance after deducting certain operating costs and other expenses is transferred to the TCBA. When the TCBA reaches zero the transition costs are fully recovered and the rate freeze is lifted. CPUC twice changed its position on whether a negative TRA balance should be transferred to the TCBA, initially yes, then no, and then on March 27, 2001 yes (Accounting Decision). The Accounting Decision required utilities to file revised tariffs and restate TRA and TCBA by April 11, 2001. The effect of the Accounting Decision was to freeze PG&E rates. PG&E brought an adversary proceeding against CPUC and the commissioners in their official capacities and sought an injunction prohibiting enforcement of the Accounting Decision and alleging that the action affected its permissible rates and thus violated the automatic bankruptcy stay.[34] CPUC moved to dismiss the action on sovereign immunity grounds or for summary judgment.[35]

The bankruptcy court ruled (1) the *Ex Parte Young* exception to sovereign immunity applied against the Commissioners;[36] (2) the Section 362(b)(4) exception to the automatic stay applied to CPUC's implementation and enforcement of the Accounting Decision;[37] (3) that although the court had greater power to grant PG&E relief under

[34] *In re Pacific Gas & Elec. Co.*, 263 B.R. 306, 309 (Bankr. N.D. Cal. 2001).
[35] *Id*. at 310.
[36] *Id*. at 316.
[37] *Id*. at 320.

Section 105 than under Section 362, there was no basis for granting an injunction;[38] and (4) that CPUC was entitled to a dismissal.[39] The effect of the bankruptcy court's ruling was to reaffirm the right of the commission to set interim rates.

Preemption

PG&E and its parent corporation (together Proponents) filed a disclosure statement and plan of reorganization on September 20, 2001, the core of which was disaggregation. The bankruptcy court set December 19, 2001 as the date for Proponents to file a revised plan and disclosure statement and directed that the revised disclosure statement include a specific description of the laws and regulations which Proponents sought to preempt through confirmation of the plan and the governmental units affected by preemption.[40]

Proponents asserted that § 1123(a)(5) preempted any otherwise applicable non-bankruptcy law, including all statutes, rules, orders and decisions of CPUC otherwise applicable to the restructuring transactions included in the plan.[41] Proponents failed to list specific law and regulations, the court felt that the CPUC was most concerned about the following:

1. Cal. Pub. Util. Code § 377 (prohibiting transfer of generating assets to an affiliate and requiring CPUC approval for other transfers);
2. Cal. Pub. Util. Code § 451 (regulating procurement of net open position and transfer of any assets to affiliates);

[38] *Id*. at 321.
[39] *Id*. at 323.
[40] *In re Pacific Gas & Elec. Co.*, 273 B.R. 795, , Mem. Dec. at 2 (Bankr. N.D. Cal. 2002).
[41] *Id*. at , Mem. Dec. at 6.

3. Cal. Pub. Util. Code § 453 (regulating transactions with affiliates);

4. Cal. Pub. Util. Code §§ 816-830 (governing the issuance of debt and securities by a public utility);

5. Cal. Pub. Util. Code § 851 (requiring approval of CPUC to sell, lease, assign, mortgage, or otherwise dispose of or encumber public utility property, including certificates of public convenience and necessity);

6. CPUC Resolution L-244 (Prohibition of transfer of gas transmission assets to FERC jurisdiction without CPUC approval);

7. CPUC Gain on Sale Rules (allowing CPUC to apply proceeds from property sold or impute a gain on property transferred according to rules established in prior decisions); and

8. CPUC Order D.01-12-017 (CPUC reservation of right to claim a return of full value of asset to ratepayers for transferred assets.[42]

The bankruptcy court decided that there was no express preemption of non-bankruptcy law by § 1123(a)(5)[43], did not decide whether Proponents could establish implied preemption,[44] and refused to apply the *Ex Parte Young* doctrine against CPUC at that stage of the proceedings.[45]

PG&E appealed the bankruptcy court's order to federal district court.[46] The district court ruled that § 1123(a)(5) expressly preempted any state laws relating to restructuring transactions.[47]

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[42] *Id*. at , Mem. Dec. at 8-9.
[43] *Id*. at , Mem. Dec. at 22.
[44] *Id*. at , Mem. Dec. at 37.
[45] *Id*. at , Mem. Dec. 45-46.
[46] *In re Pacific Gas & Elec. Co.*, 283 B.R. 41, , Order at 1 (N.D. Cal. 2002).

CPUC appealed the district court decision to the 9th Circuit. A decision has not yet been rendered. If a decision is rendered (the appeal may become moot and be dismissed if the parties agree to a reorganization plan[48]), it will be binding authority for courts within the circuit and persuasive authority elsewhere.

IMPLICATIONS FOR THE COMMISSION

Will the Commission Be Allowed to Participate in the Bankruptcy Proceedings?

There are three types of participation related to a main bankruptcy proceeding. A party can participate as a creditor, a party-in-interest, or an intervenor. A creditor has the greatest rights. It can object to other claims, object to classifications, propose a plan of reorganization, make motions and file briefs on any issue, vote on a plan of reorganization, and appeal decisions by which it is harmed. A party-in-interest can do all of the same except vote on a plan or reorganization. An intervenor potentially has all of the rights of a party-in-interest. However, the bankruptcy court may limit an intervenor's participation in any way that it sees fit.

In PSNH the NHPUC was granted full party-in-interest status. In Cajun the LPSC took a very active role. Since Commission approval is required for any rate changes contemplated by the reorganization plan, and since the Commission retains police and regulatory authority, it is very likely that it would be granted party-in-interest status.

Will the Commission Set Rates During the Pendency of the Bankruptcy?

Generally the Commission will retain its normal ratemaking authority. The authority can be limited by a bankruptcy court order pursuant to § 105. Although the

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[47] *Id*. at , Order at 10.

[48] On June 19, 2003, PG&E and CPUC announced a settlement agreement. On June 27, 2003, PG&E filed a disclosure statement for the plan provided for in the settlement agreement. A hearing on confirmation of the proposed plan has not been scheduled as of July 3, 2003.

commentary is split, no bankruptcy court has determined that it could order a utility or a commission to raise rates during the pendency of a proceeding. There is a split of authority as to whether or not the Commission can change rates based on the effects of the bankruptcy filing. This was prohibited in PSNH, but permitted in Cajun. If the Commission were to choose to change rates because of changed circumstances related to a bankruptcy filing, it should be prepared to litigate the matter.

Who Will Operate the Business During the Pendency of the Bankruptcy?

A trustee or the debtor-in-possession has the authority to make ordinary course of business decisions and to operate the business. In all likelihood the business will continue to operate as prior to the filing. As one commentator has stated regarding utility bankruptcies, "the lights didn't go out. Moreover, the businesses continued to run."[49]

Transactions and decisions not in the ordinary course of business will require bankruptcy court approval. Transactions made pursuant to § 363, rather than to implement a plan of reorganization, should require commission approval to the same extent that they would have outside of bankruptcy.

What Commission Approval Will Be Required?

If the 9th Circuit upholds the district court's decision regarding preemption, the role of the Commission will be restricted to ratemaking.[50] Even so, the Commission will likely be able to engage in all activities related to its ratemaking function.

If the 9th Circuit reverses the district court's decision regarding preemption, the Commission will be in a better but not perfect position. Absent specific statutory

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[49] J. Michael Parish, Presentation to Standard and Poors (Apr. 15, 2002) (transcript available at http://class-1965.princeton.edu/parish/SandP.html)

[50] A Court of Appeals decision is mandatory authority within its circuit and persuasive authority elsewhere. A utility may not file in the circuit. For example, Touch America has filed in Delaware which is in the 3rd Circuit. South Dakota is in the 8th Circuit.

authority, the Commission will need to argue and prevail that the imposition of a "duty to supervise and regulate the operations of public utilities"[51]and the general grant of "full power of supervision, regulation and control"[52] of public utilities provides it with the authority it seeks to assert. Most likely, Commission approval will not be required for approval of a reorganization plan.

[51] Rev. Code Ann. § 69-1-102.
[52] Rev. Code Ann. § 69-3-102.